



**U.S. Department of
Transportation**

Office of the Secretary
of Transportation

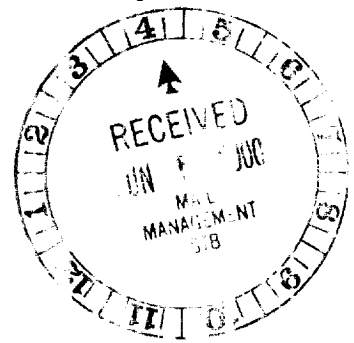
GENERAL COUNSEL

400 Seventh St., S.W.
Washington, D.C. 20590

ORIGINAL

June 5, 2000

Vernon A. Williams, Secretary
Surface Transportation Board
Suite 700
1925 K Street, N.W.
Washington, D.C. 20423-0001



198898

Re: Major Rail Consolidation Procedures
Ex Parte No. 582 (Sub-No. 1)

RECEIVED
Office of the Secretary

JUN 05 2000

Dear Secretary Williams:

Pursuant to the Decision served March 31, 2000, enclosed herewith are the original and twenty-five copies of the Reply Comments of the U.S. Department of Transportation in the above-referenced proceeding. This document is also contained on the enclosed computer diskette, formatted for WordPerfect 5.1.

Respectfully submitted,

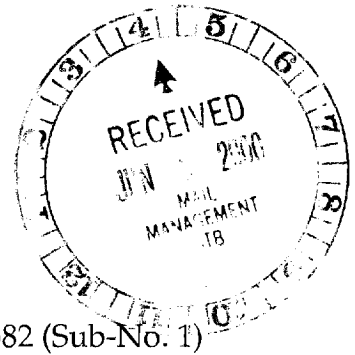
Paul Samuel Smith
Senior Trial Attorney

Enclosures

cc: All Parties of Record

ORIGINAL

Before the
Surface Transportation Board
Washington, D.C.



Major Rail Consolidation Procedures

Ex Parte No. 582 (Sub-No. 1)

Reply Comments of the
United States Department of Transportation

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Office of the Secretary

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Part of
Public Record

I. INTRODUCTION

The United States Department of Transportation ("Department" or "DOT") believes that the initial round of comments in this proceeding, together with replies, gives the Surface Transportation Board ("STB" or "Board") an ample record upon which to proceed expeditiously to revise the regulations governing consolidations of major railroads. The parties' comments have been thorough and thoughtful, exploring a variety of issues relevant to a comprehensive analysis of the effects of potential mergers on the health of the rail system, the efficiency of its operations, and its responsiveness to customers and employees. Like DOT, the parties submitting comments acknowledged the importance of this proceeding, and generally noted the risks associated with allowing any merger to proceed where the public benefits were insufficient to outweigh potential harm.

Although views on many specific issues vary greatly, the Department was pleased to see that there is significant consensus in several major areas, particularly those related to merger implementation, post-merger service, and oversight. There is even agreement on some aspects of competition and competitive access, although views on the appropriate way to address these subjects vary among the parties.

As discussed below, the initial comments provide no basis for DOT to depart from the views expressed in its initial filing in this proceeding.

II. SERVICE STANDARDS

The Department notes that there is significant agreement regarding changes to the merger rules that would lay the groundwork for monitoring and maintaining acceptable customer service levels during the critical post-merger transition period. Rail carriers, shipper associations and ports all endorsed the measurement and publication of service-related data for a reasonable period both preceding and following a merger. There was also general consensus that the Board should require merger applicants to submit service plans for the transition period, including contingency plans in the event of a service breakdown. A broad range of commentators also endorsed continued oversight by the Board for a period following major consolidations.

Although there was broad support for new merger rules that would focus greater attention by the applicants and the Board on customer service levels, there was substantial disparity among the commentators on the subject of remedies and penalties in the event of a service breakdown during the transition period. At one end of the spectrum, parties such as the Norfolk Southern Railway Co. ("NS") cautioned that the Board should not involve itself in issues of this nature. Comments of NS at 22-24. At the other end, shipper representatives such as Western Coal Transportation Association ("WCTA") proposed that the Board enforce a system of specific remedies and penalties for shippers that have been economically harmed by service lapses following railroad mergers. Comments of WCTA at 4-5.

Many others, including the Department, recommended a middle ground that would encourage merger applicants to offer shippers service guarantees. The Board's role under such an approach would be to ensure that the applicants had proffered shippers service commitments that were in the public interest. Comments of DOT at 9-10. The Board would also ensure that shippers, and small shippers in particular, had a viable means for resolving service disputes with the applicants.

The Department is encouraged that so many parties, including the rail carriers, made service a major theme of their filings. There are a number of well-developed proposals grounded in the experience of recent mergers that provide the Board a firm basis for developing rules for measuring service and defining the scope and content of transitional service plans. See Comments of the Burlington Northern and Santa Fe Railway Co. ("BNSF") at 17-20; National Industrial Transportation League ("NITL") at 19-20. We again urge the Board to pay particular attention to developing and requiring measurements that would define service levels from the shipper perspective. See Comments of DOT at 6-7.

Service guarantees present a more difficult challenge. Again, there were a number of innovative suggestions detailing how applicants and shippers could negotiate mutually satisfactory arrangements to guarantee minimum service levels in a manner that would protect the interests of both parties. *See, e.g.,* Comments of NITL at 19-20; Edison Electric Institute ("EEI") at 6-7. We continue to believe that the Board should not require railroads to offer service guarantees. However, the STB should take into account any reluctance by applicants to offer serviced commitments and meaningful dispute resolution systems when it evaluates the benefits and risks of a merger.

The Department opposes direct regulation of service levels by the Board. We encourage the Board to establish a process that allows applicants and affected parties to decide on mechanisms to resolve service disputes in an expeditious and efficient manner, but do not believe the STB should be directly involved in adjudicating individual disputes.

III. LABOR ISSUES

As we expressed in our initial comments, the Department's preference is that the Board eliminate the use of cram down in future mergers. Comments of DOT at 24. However, the Department recognizes that the STB believes it does not have the statutory authority to take this step, and we therefore offered our own suggestions on how the Board could better balance the interests of employees and the carriers, as part of this proceeding. *Id.*

The Department also notes that several rail labor organizations that are strongly opposed to cram down offered suggestions on how the Board could ameliorate the impact of cram down by modification of the existing regulatory framework. *See, generally,* the Comments of Transportation Communications International Union, International Brotherhood of Electrical Workers, American Train Dispatchers Department, and International Association of Machinists. The union proposal would permit employees a greater voice in the selection of the surviving agreement; and, most importantly, it would limit the carriers' ability to bypass the Railway Labor Act ("RLA") simply to gain operating efficiencies. DOT believes that these suggestions are productive, and urges the Board to seriously consider them.

The Department also endorses the recommendation of the labor organizations to update existing procedures to provide employees targeted for relocation an alternative to the dilemma of choosing between a long-distance move or the forfeiture of New York Dock benefits. *See* Comments of the Transportation Trades Department, AFL-CIO ("TTD") at 23. Relocation is an issue that may cause greater hardship for affected employees as future mergers

expand the possibility of relocation to virtually any point in the continental United States.

Finally, the Department also supports the recommendation of the TTD that applicants proposing a trans-national merger be required to reveal their cross-border work-transfer intentions before approval is granted. Comments of TTD at 36.

IV. COMPETITION

A. Open Gateways

Shipper and railroad parties' initial comments on competition issues generally differed greatly. However, one area where the commentators tended to reach consensus was on the question of gateways. Virtually all shippers and railroads agreed in principle that major gateways affected by mergers should remain open. However, even here there is a divergence of opinion on the details. For example, the Union Pacific Railroad Co. ("UP") called for restricting relief to those shippers affected by a merger, and then only if prior to the merger they shipped a minimum of 100 cars per year over the route in question. Comments of UP at 12-13. Further, the railroads strongly oppose any ruling that could be construed as a return to DT&I conditions, routinely imposed in pre-Staggers Act era mergers, which required open routings and equalized rates that prevented carriers from realizing efficiencies from combining systems, and protected competitors rather than competition.¹ Other parties, notably the United States Department of Agriculture ("USDA"), essentially endorse the equivalent of DT&I conditions for maintaining gateways and routes. Comments of USDA at 16.

As stated in our initial comments, DOT believes that the STB should require gateways to remain open on major routes; to be fair to affected shippers and merger applicants, this requirement should bind all carriers serving the gateway. The Board must assure that rates established to and from the gateway will preserve competitive joint-line options, at rate levels that foster productive efficiency. Such oversight will prevent a return to the protective policies embodied in the DT&I conditions.

Additionally, we urge the Board to reject the type of restrictive conditions recommended by Union Pacific that would limit open routings to shippers with a history of prior use. Conditions should be designed so that they can be

¹/ Rulemaking Concerning Traffic Protective Conditions in Railroad Consolidation Proceedings, 366 I.C.C. 112 (1982), *aff'd sub nom. Detroit, Toledo & Ironton Railroad Co. v. ICC*, 725 F.2d 46 (6th Cir. 1984).

implemented easily, without prolonged litigation to determine if parties are eligible to take advantage of them.

B. Terminal Switching

Based on their comments, shippers (including ports) universally support switching that is truly open – both physically and economically. Railroads, on the other hand, generally oppose open switching, beyond guaranteeing that shippers losing switching due to a merger would be “made whole.” The railroads view the switching proposal, along with other access issues, as a direct attack on the system of differential pricing necessary to recover full costs.

The Department continues to urge the Board to establish open or reciprocal switching in terminal areas, which generally include ports, to preserve and enhance geographic competition in the already concentrated railroad industry. DOT believes that open switching at terminal areas can support this type of competition and, consequently, included a provision to that effect in its legislative proposal for STB reauthorization. However, as we have already noted, to be effective in an open switching setting, switching fees must be set (through negotiation, or through STB order) at levels that encourage competition, reimburse the carrier performing the switching for its costs, and provide sufficient financial incentive for the performing carrier to continue needed investment in infrastructure. Comments of DOT at 14-15.

C. “Three-to-Two” Issue

Railroads are uniformly opposed to a general rule that would maintain three railroad service in situations where merger would reduce the number of serving railroads to two; they consider that the need for three railroads to preserve adequate competition should be determined on a case-by-case basis. Shippers, on the other hand, generally favor retention of three-railroad competition in merger situations. However, shipper views tend to diverge widely on the application of this criterion in practice. The National Industrial Transportation League (“NITL”) believes that reexamination of the present policy serves no purpose, since probably no area of the country is now served by more than two carriers whose networks, or even portions of whose networks, extend over the same corridors. Comments of NITL at 11. Consequently, the NITL urges the Board not to pursue this issue further in this proceeding. At the other end of the shipper spectrum, some parties imply that the Board should revisit past mergers to introduce or restore a third railroad competitor. Comments of IMPACT at 9; State of New York at 10..

As we stated in our initial comments (and adopted in Finance Docket No. 32760, the merger of the UP and Southern Pacific Transportation Co.), economic theory holds that the issue of whether two railroads can provide sufficient

competition is indeterminate, and should be decided on the specifics of the situation in each case. Comments of DOT at 16-17. DOT continues to maintain that position, and urges the Board neither to establish a rule automatically maintaining three railroads in merger cases nor to assume that two are always sufficient. We agree with the NITL that the issue is now generally moot, but nevertheless believe it would be useful for the Board to reaffirm its present policy on this question, and continue to evaluate the competitive situations presented in each case based upon the evidence.

With regard to the suggestion that three railroad competition be restored, we believe the Board should always be ready to reexamine its decisions in past mergers to provide necessary remedies for unforeseen problems. However, such reexamination should address only specific situations on a case-by-case basis, and the burden of proof should be on the complainant or moving party to establish that the remaining two serving railroads fail to provide adequate competition.

D. "Bottleneck" Relief

Shippers' comments generally support policies that advance competitive access. Railroads uniformly maintain that the access question is an industry-wide issue separate from merger rules, but disagreed somewhat on the specific application of what they term the "contract exception" stemming from the Board's bottleneck decision. All railroads oppose being compelled to issue bottleneck shippers contracts for upstream/downstream movement beyond the bottleneck. Some, such as BNSF, are willing, albeit reluctantly, to provide a bottleneck shipper affected by the merger a rate to a junction with another carrier offering a contract. Comments of BNSF at 26-27.

However, the NITL and the Chemical Manufacturers Association/American Plastics Council (collectively, "CMA") carry their advocacy of this issue beyond the merger setting. NITL contends that the STB should use its broad legal authority to revise the rules on competitive access, through routes and joint rates, and rates and practices to generally enhance competition. Comments of NITL at 12, 16-18. The CMA urges the Board to provide all solely-served shippers with a second railroad. Comments of CMA at 1-5.

DOT maintains its initial position on this issue. We continue to believe that railroads should not, and under the Staggers Act legally cannot, be forced to issue bottleneck shippers contracts for the upstream/downstream leg of potential joint-line movements. On the other hand, where a bottleneck shipper already has such a contract, it should not be required to first go through a proceeding to establish access, and then a second proceeding to challenge a rate.

We urge the Board to streamline the current procedure in merger cases to eliminate the first step of this two-step process. *See* Comments of DOT at 15-16.

From a broader standpoint, DOT believes competitive access embraces far-reaching industry-wide issues that should be resolved in a separate rulemaking, or by statute, after a full debate about the implications for rail costs, rates, and service. In that regard, we believe that, although not explicitly stated, such a forum is what the NITL and CMA are calling for in their comments, and the railroads uniformly suggest in their submissions. DOT urges the Board to give this approach serious consideration.

V. SHORT LINE AND REGIONAL RAILROAD ISSUES

In its initial statement in this proceeding, DOT addressed short line and regional railroad concerns advanced by the American Short Line and Regional Railroad Association ("ASLRRA").² Our comments focused on Class I service, interchange and routing, pricing, and car supply to Class II and Class III railroads as they relate to the merger process. Although the Department did not totally agree with the ASLRRA's request for conditioning mergers on each of the elements contained in their short line "bill of rights," we did agree that: (1) merging Class I railroads should provide service guarantees with negotiated compensation for service failures during operations integration; (2) gateways should remain open in order to preserve continued Class I options for shippers and small carriers; and (3) small carriers should be included in the operations planning and coordination with their merging Class I partners. Comments of DOT at 19-23. However, we supported removal of "paper barriers" only to address specific merger issues, or, on a temporary basis, to resolve implementation problems. DOT does not favor conditioning mergers with regard to discriminatory pricing and discriminatory car supply issues unless a link can be made to a merger proposal. *Id.* We repeat our recommendation that the Board review these issues outside the instant proceeding.

As expected, a number of parties commented on the proposals made by the ASLRRA. Some parties endorsed outright adoption of the "bill of rights," while others addressed only specific issues. *See, e.g.,* Comments of the State of Maryland at 9; Eastern Shore Railroad at 4; American Forest and Paper Products Association at 4. Some questioned the legality of paper barriers, stating that they

²/ Statement of Frank K. Turner, President, ASLRRA, filed March 8, 2000 and Comments of the American Short Line and Regional Railroad Association, STB Ex Parte No. 582 (Sub-No. 1), May 16, 2000.

should be removed. *See* Comments of EEI at 7-8; Alliance for Rail Competition ("ARC") at 4; Montana Wheat and Barley Committee *et al.* at 7. Others recommended that the Board remove such barriers if the parent Class I had already received reasonable economic benefits from the creation of the smaller carrier. *See* Comments of NITL at 20-21. Class I carriers did not believe the barriers should be removed, at least in a merger proceeding. *See* Comments of CSX at 27; UP at 15-16.

Others parties focused on the Class I service problems during the last round of mergers and the adverse consequences that shippers and small railroads faced. *See* Comments of the Society of the Plastics Industry at 12; USDA at 11. Recommended solutions centered on service benchmarks with negotiated remedies and penalties based upon those benchmarks and the carriers' service plan. *See* Comments of UP at 6-9; NITL at 19-20; BNSF at 16-19; WCTA at 4-5.

Overall, the issues raised by the ASLRRA and addressed by the Department and other parties in this should be reviewed in the context of their applicability to merger and consolidation proceedings. If the Board agrees that some of these issues (most notably, paper and steel barriers) generally lie outside merger rules but should be addressed separately, it should not hesitate to move forward and conduct the proper review.

VI. AMTRAK/COMMUTER RAIL

The filings of Amtrak and the commuter rail agencies complemented that of the Department. Passenger rail operators expressed strongly their concerns with the poor service resulting from recent mergers. *See* Comments of the State of Maryland at 3; Southern California Regional Railroad Authority ("SCRRA") at 3; American Public Transit Association ("APTA") at 3. Unreliable service is particularly detrimental for passenger operators because they must compete with automobiles and other readily available alternatives. Comments of APTA at 2. Ridership declines due to poor service may take months if not years to reverse.

The Department joins with the passenger rail operators in continuing to urge the STB to adopt new merger rules that address these problems, including transition service plans and prior consultations with the passenger operators, as mentioned in some of the filings. Comments of Amtrak at 5-7, 10; State of Maryland at 3; SCRRA at 4; Metra at 5. Consultations with passenger operators may help to identify potential problems and explore possible alternatives in the event of service disruptions.

VII. ENVIRONMENT

The Department notes that several respondents joined with the Department in urging the STB to consider environmental issues in this proceeding. Comments of the Ohio Rail Development Commission ("ORDC") at 7; City of Cleveland at 3; Mayo Clinic at 4. The need for more effective means for dealing with the impacts of major consolidations on communities is clear. The Department continues to support a review of alternatives in order to address community impacts more equitably. We also suggest that the proposal of ORDC (at 7) for arbitrating the differences between smaller communities and the railroads should be explored more fully. The Department urges the Board to add environmental issues to the forthcoming notice of proposed rulemaking in this proceeding.

VIII. PUBLIC BENEFITS

A number of respondents noted the need to more carefully identify public benefits from future mergers and balance them with potential harms. *See, generally*, Comments of NITL, Glass Producers Transportation Council, Proctor & Gamble, and USDA. The poor service that has been the result of recent mergers makes claims of the public benefits from single-line service especially questionable. Several commuter railroads recommended that the STB consider the public benefits of enhanced commuter service in determining the future benefits of mergers. Comments of SCRRRA at 3, State of Maryland at 3. Enhanced passenger service is clearly a public benefit, and the Department supports this recommendation. DOT continues to urge the STB to clarify its approach to quantifying the estimates of public benefits and to monitoring the realization of the benefits claimed.

IX. ACQUISITION AND IMPLEMENTATION COSTS

Echoing our comments in Finance Docket No. 33388 (the Conrail Acquisition Case), the Department's initial filing in this proceeding cited the "acquisition premium" issue raised in other proceedings, and noted our expectation that parties would offer suggestions on ways to ensure that excessive costs were not automatically passed on to shippers. Comments of DOT at 18. Although several parties noted the issue, *e.g.*, the Comments of Subscribing Coal Shippers, *et al.* at 24, we do not believe that the record on this subject is sufficiently developed for the Board to make a judgment as to the proper definition of "acquisition premium," or on the best way to prevent a pass-through

of such amounts. We urge the STB to explore this issue further in a separate proceeding.

Similarly, we urge the Board to reassess how carriers account for unanticipated and significant merger implementation costs. The Board's recently-issued decision in Finance Docket No. 33276 notwithstanding, the Department believes that the STB should ensure that such costs are not incorporated into the Uniform Rail Cost System, to become part of the base by which rates are determined.

X. INTERNATIONAL ISSUES

The Department expressed concern that consolidations of major U.S. and foreign railroads could raise issues that are qualitatively different from those presented in mergers of domestic carriers. Comments of DOT at 31-35. We offered several possible examples, such as different legal or regulatory regimes, decisionmaking based upon national rather than commercial considerations, control issues, and national defense. *Id.* DOT accordingly urged the Board to require the compilation of a complete record on which to base its ultimate decision. *Id.*³

Most other parties that addressed this subject in their initial comments agree. *See* Comments of the Commonwealth of Virginia at 3; Joint Comments of the Kansas Department of Transportation, *et al.* at 13-15; Canadian Pulp and Paper Association at 3-4; NITL at 21-22; National Grain and Feed Association at 4; CSX at 24-26; Military Traffic Management Command at 8-9.⁴ What disagreement there is on this point appears to be based on concerns that new rules would either discourage or prohibit such transactions, or run afoul of existing legal obligations or arrangements designed to address such issues. *See*

³/ This would include a requirement that applicants in such cases submit information pertaining to the entire merged system, and not just that part that they considered relevant to the U.S. *See* Comments of NITL at 21-22; CSX at 24-25; Canadian Pacific Railway Co. at 20-21 (no objection "in principle"); NS at 62-63; UP at 19-20.

⁴/ Some parties go farther and point to concrete examples of longstanding disputes in this area, particularly with Canada, and urge the Board to create a "level playing field" through the imposition of conditions. *See* Comments of North Dakota Public Service Commission, *et al.* at 7-8 (regarding grain); USDA at 19-21 (regarding rail car supply).

Comments of BNSF at 31-33; Canadian National Railway Co. at 47-51; Wisconsin Central System ("WC") at 13-15.⁵

Increased scrutiny of future consolidations of Class I carriers generally is indeed likely to make the STB review process more arduous than before. But that is as it should be. Attention given to the possibility of different or unfamiliar issues in transactions resulting in massive international rail systems is simply one aspect of the heightened concern for unprecedented combinations that virtually all parties share.

DOT has no wish to interfere with whatever legal infrastructure may already be in place to address some or even all of the concerns that arise in such mergers. We remain committed, however, to ensuring that the Board and interested parties have access to all relevant information. Only in that way can there be certainty whether, for example, a different forum exists to resolve some or all of the issues raised in a given record. Where no mechanism exists to answer identified questions, however, the STB would then be prepared to do so.


In the interests of informed decisionmaking, the Department endorses the suggestion made by several parties that the Board engage in consultations with pertinent agencies of other governments that are also charged with oversight of some or all of a given transaction. *See* Comments of Canadian Resource shippers Association at 9; Western Canadian Shippers Coalition at 3-4. This would serve at least two purposes. First, it would minimize the possibility of misunderstanding of the effects of other relevant law or its application. Second, it would provide information to decisionmakers of each agency on the status and prospects of other reviews of the same transaction. In this way consultation could reduce the potential for inconsistent conditions or outcomes or other hallmarks of uncoordinated action.

⁵/ Some parties do not disagree with focusing attention on such issues, but believe that this should be done on a case-by-case basis. *See* Comments of WC at 13-14; Comments of NS at 62. DOT considers that codifying the requirements will put affected carriers on notice at the outset of their obligations, more efficiently produce the desired record, and be more likely to result in decisionmaking consistency.

XI. CONCLUSION

The Department strongly supports the Board's decision to reconsider the criteria by which it judges major railroad consolidations. Although doing so via the alternative of decisions in individual merger cases would have been preferable from DOT's perspective, the record produced in this proceeding provides ample basis to adopt provisions in such areas as rail service, transborder issues, and others. It also suggests that reassessment of other subjects should be left to non-merger-related proceedings. We urge the STB to proceed expeditiously to promulgate new standards

Respectfully submitted,

A handwritten signature in black ink, reading "Nancy E. McFadden". The signature is fluid and cursive, with a long horizontal line extending to the right.

NANCY E. McFADDEN
General Counsel

June 5, 2000

CERTIFICATE OF SERVICE

I hereby certify that on this date I have caused a copy of the foregoing Reply Comments of the United States Department of Transportation in Ex Parte No. 582 (Sub-No. 1) to be served upon all Parties of Record by first class mail, postage prepaid.

A handwritten signature in cursive script, reading "Paul Samuel Smith", written over a horizontal line.

Paul Samuel Smith

June 5, 2000